

**STATE LOTTERY DEPARTMENT
OF THE
COMMONWEALTH OF VIRGINIA
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEARS ENDED
JUNE 30, 2002 AND 2001**



AUDIT SUMMARY

Our audit of the State Lottery Department of the Commonwealth of Virginia for the years ended June 30, 2002 and 2001, found:

- the financial statements are presented fairly, in all material respects;
- no internal control matters that we consider material weaknesses; and
- no instances of noncompliance required to be reported under Government Auditing Standards.

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August 19, 2002

The Members of the Virginia State Lottery Board
900 East Main Street
Richmond, Virginia

We have audited the accounts and records of the **State Lottery Department of the Commonwealth of Virginia** as of and for the years ended June 30, 2002 and 2001, and submit herewith our complete reports on financial statements and compliance and internal controls.

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic statements of the State Lottery Department as of and for the years ended June 30, 2002 and 2001, as listed in the Table of Contents. These basic financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts, and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1A, the basic financial statements of the Department are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the business-type activities and the major enterprise fund of the Commonwealth of Virginia that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the Commonwealth of Virginia as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 14, the Department has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, as of June 30, 2001.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State Lottery Department as of June 30, 2002 and 2001, and changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements of the State Lottery Department as of and for the years ended June 30, 2002 and 2001, we considered internal controls over financial reporting and tested compliance with certain provisions of laws, regulations, and contracts in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Governmental Auditing Standards.

Compliance

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal controls over financial reporting and its operation that we consider to be material weaknesses.

The "Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting" is intended solely for the information and use of the Governor and General Assembly of Virginia, the Virginia State Lottery Board and Lottery management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on September 25, 2002.

AUDITOR OF PUBLIC ACCOUNTS

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FINANCIAL STATEMENTS

STATE LOTTERY DEPARTMENT
STATEMENT OF NET ASSETS
As of June 30, 2002 and 2001

	2002	2001
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	\$ 10,289,986	\$ 23,419,088
Cash held as collateral (Note 2)	131,149,347	233,477,079
Accounts receivable	36,195,079	32,589,851
Due from the Lottery Proceeds Fund (Note 5)	-	439,460
Instant ticket inventory (Note 4)	3,545,374	3,097,723
Deferred expenses	1,295,929	1,484,014
Short-term investments (Note 2)	57,151,454	56,368,389
Total current assets	239,627,169	350,875,604
Investments (Note 2)	392,542,511	405,274,523
Fixed assets: (Note 3)		
Furniture, fixtures and equipment	40,540,734	55,422,399
Less: Accumulated depreciation	(19,690,602)	(33,799,672)
Net fixed assets	20,850,132	21,622,727
Total assets	\$ 653,019,812	\$ 777,772,854
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	\$ 12,382,078	\$ 9,309,238
Due to the Lottery Proceeds Fund (Note 5)	2,719	-
Compensated absences (Note 8)	731,392	740,055
Obligations under securities lending (Note 2)	131,149,347	233,477,079
Prizes payable: (Note 6)		
Jackpot prizes payable	57,151,454	56,368,389
Other	43,204,831	58,011,632
Deferred revenue	2,833,874	2,401,226
Installment notes payable (Note 7)	2,701,495	2,080,372
Total current liabilities	250,157,190	362,387,991
Long-term liabilities:		
Installment notes payable (Note 7)	9,466,132	9,318,028
Jackpot prizes payable (Note 6)	392,542,511	405,274,523
Compensated absences (Note 8)	853,979	792,312
Total liabilities	653,019,812	777,772,854
Net Assets:		
Invested in capital assets, net of related debt	8,682,504	10,224,327
Unreserved	(8,682,504)	(10,224,327)
Total net assets	-	-
Total liabilities and net assets	\$ 653,019,812	\$ 777,772,854

The accompanying notes to financial statements are an integral part of this statement.

STATE LOTTERY DEPARTMENT
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
For the Years Ended June 30, 2002 and 2001

	2002	2001
Operating revenues:		
Ticket sales	\$ 1,108,067,712	\$ 1,002,828,896
Less:		
Prize expense	613,729,867	557,252,771
Retailer compensation	62,240,342	55,870,238
Instant ticket printing	6,997,063	5,651,860
Gross margin	425,100,440	384,054,027
Operating expenses:		
Advertising and promotion	21,159,033	20,576,474
General and administration	46,550,443	46,798,184
Total operating expenses	67,709,476	67,374,658
Income from operations	357,390,964	316,679,369
Non-operating revenue (expenses):		
Interest income	9,592,873	11,366,160
Interest expense	(491,268)	-
Other income	1,200,814	1,096,863
Total non-operating income	10,302,419	12,463,023
Net income	367,693,383	329,142,392
Transfer to the Lottery Proceeds Fund	(367,690,664)	(329,581,852)
Available for transfer from (to) the Lottery Proceeds Fund	(2,719)	439,460
Net assets--July 1	-	-
Net assets--June 30	\$ -	\$ -

The accompanying notes to financial statements are an integral part of this statement.

STATE LOTTERY DEPARTMENT
STATEMENT OF CASH FLOWS
For the Years Ended June 30, 2002 and 2001

	2002	2001
Cash flows from operating activities:		
Cash received from ticket sales	\$ 1,104,895,132	\$ 997,639,195
Cash payments for prizes	(672,841,276)	(618,269,137)
Discounts for retailer compensation	(62,240,342)	(55,870,238)
Cash payments to supplier of instant tickets	(7,444,714)	(6,384,985)
Cash payments to suppliers of other goods and services	(30,111,504)	(37,597,885)
Cash payments to employees for services	(19,226,818)	(18,953,785)
Cash payments to the Literary Fund for unclaimed prizes (Note 10)	(9,195,847)	(7,461,034)
Net cash provided by operating activities	303,834,631	253,102,131
Cash flows from noncapital financing activities:		
Proceeds from other income	1,200,814	1,096,863
Transfers to the Lottery Proceeds Fund	(367,251,204)	(329,523,739)
Net cash used by noncapital financing activities	(366,050,390)	(328,426,876)
Cash flows from capital financing activities:		
Acquisition of capital assets	(2,239,183)	(4,012,357)
Principal payments on installment notes	(2,080,373)	-
Interest payment on installment notes	(491,268)	-
Net cash used for capital financing activities	(4,810,824)	(4,012,357)
Cash flows from investing activities:		
Purchase of investment securities	(13,348,392)	(22,830,932)
Sale of investment securities	-	39,105,910
Proceeds from maturing securities	57,653,000	58,928,000
Interest proceeds from cash balances	9,592,873	11,366,160
Net cash provided by investing activities	53,897,481	86,569,138
Net (decrease) increase in cash and cash equivalents	(13,129,102)	7,232,036
Cash and cash equivalents at July 1	23,419,088	16,187,052
Cash and cash equivalents at June 30	\$ 10,289,986	\$ 23,419,088
Reconciliation of operating income to net cash provided by operating activities:		
Income from operations	\$ 357,390,964	\$ 316,679,369
Adjustments to reconcile operating income to net cash:		
Depreciation	5,861,378	3,801,217
Accreted interest on investment securities	(32,355,661)	(34,259,924)
Changes in assets and liabilities:		
(Increase) in accounts receivable	(3,605,228)	(5,418,091)
(Increase) in instant ticket inventory	(447,651)	(733,125)
Decrease in deferred expenses	188,085	425,771
Increase (decrease) in accounts payable	3,072,840	(842,814)
Increase (decrease) in current prizes payable	(14,023,736)	11,871,568
Increase in deferred revenue	432,648	228,390
Increase (decrease) in accrued compensated absences	53,004	(22,220)
(Decrease) in noncurrent prizes payable	(12,732,012)	(38,628,010)
Net cash provided by operating activities	\$ 303,834,631	\$ 253,102,131

Noncash capital financing activity:

Upgrade of new on-line terminals, purchased through Master Equipment Leasing Program, equipment valued at \$14,248,000.

The accompanying notes to financial statements are an integral part of this statement.

The FY 2001 Statement of Cash Flows shown above reflects a reclassification to separately report installment notes payable in the amount of \$11,398,400. The reclassification reports these proceeds as a noncash financing activity rather than an operating activity.

NOTES TO FINANCIAL STATEMENTS

STATE LOTTERY DEPARTMENT

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2002 AND 2001

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The State Lottery Department (Virginia Lottery) was established by Chapter 531 of the 1987 Acts of Assembly and operates as an independent agency in accordance with the provisions of Chapter 40 of Title 58.1 of the Code of Virginia.

A separate report is prepared for the Commonwealth of Virginia, which includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The Virginia Lottery is an agency of the Commonwealth of Virginia and is included in the general-purpose financial statements of the Commonwealth.

B. Basis of Accounting

The basis of accounting is an accrual basis where revenues are recognized when earned and expenses when incurred. On-line ticket revenue is recognized as corresponding drawings are held. Instant ticket revenue is recognized when tickets are sold to retailers.

C. Revenue and Expense Classifications

Operating revenues and expenses include activities related to the sale of lottery tickets. Operating expenses include prizes to winners, compensation to retailers and instant ticket printing costs. Nonoperating revenues and expenses include activities that have the characteristics of investing transactions and capital and noncapital financing activities as defined by GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB Statement 34.

Nonoperating revenues include interest income from its cash balances held with the Treasurer of Virginia. Nonoperating expenses include interest on debt related to the purchase of capital assets and losses on the disposal of capital assets. In FY 2001 and FY 2002 the Lottery purchased 4,200 new on-line terminals (ISYS).

D. Fund Accounting

The activities of the Virginia Lottery are accounted for in an enterprise fund, used to account for governmental operations that are financed and operated in a manner similar to private business enterprises. Enterprise fund accounting is used where the governing body has decided that periodic determination of revenues earned, expenses incurred, and net income is appropriate.

E. Property, Plant, and Equipment

Fixed assets are capitalized and depreciated on a straight-line basis over their useful lives. Fixed assets are valued at historical cost or estimated historical cost. Donated fixed assets are capitalized at estimated market value at the date of contribution. The Virginia Lottery capitalizes all property, plant, and equipment that have a cost or value equal to and greater than \$3,000 and an expected useful life of at least three years.

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

Cash and cash equivalents represent cash with the Treasurer of Virginia, deposits and overnight repurchase agreements. Cash with the Treasurer of Virginia is held pursuant to Section 2.2-1800, et seq., Code of Virginia. These funds are held in pooled accounts and, accordingly, are not categorized as to credit risk as defined by Statement 3 of the Governmental Accounting Standards Board. Cash on deposit is held in demand deposit accounts maintained for prize payments and is covered by federal depository insurance with the balance in excess of this insurance collateralized in accordance with the Virginia Security for Public Deposits Act. Under that Act, banks holding public deposits in excess of the amounts insured by FDIC pledge collateral in the amount of 50 percent of deposits in excess of FDIC insurance coverage to a collateral pool held in the name of the State Treasury Board.

Investments (current and long-term) consist of U.S. Treasury STRIPS purchased to fund individual jackpot and "For Life" prizes. Investments are valued at cost plus accrued interest. Market values are reported for informational purposes as it is management's intention to hold these securities to maturity.

Statutes authorize the investment of funds held by the Virginia Lottery in obligations of the Commonwealth, Federal Government, other states or political subdivisions thereof, the International Bank for Reconstruction and Development, the Asian Development Bank and the African Development Bank. In addition, the Virginia Lottery may invest in prime quality commercial paper rated prime 1 by Moody's Investment Service or A-1 by Standard and Poor's Incorporated, overnight term or open repurchase agreements and money market funds comprised of investments which are otherwise legal investments of the Virginia Lottery.

Cash on deposit, short-term investments, and investments are categorized below to give an indication of the level of credit risk assumed by the Virginia Lottery. Credit risk is the risk that the Virginia Lottery may not be able to obtain possession of its investment instruments or collateral at maturity. Risk category 1 includes investments which are insured or registered or for which the securities are held by the Virginia Lottery or its safekeeping agent in the Virginia Lottery's name. Risk category 2 includes uninsured or unregistered investments for which the securities are held by the broker's or dealer's trust department or safekeeping agent in the Virginia Lottery's name. There are no accounts or investments in this category. Risk category 3 includes uninsured or unregistered investments for which the securities are held by the broker or dealer, or by its trust department or safekeeping agent but not in the Virginia Lottery's name.

Securities Lending

As authorized by Section 2.2-4506 of the Code of Virginia, the Virginia Lottery, through its master custodian, JP Morgan Chase Bank, New York, N.Y., N.A., lends securities to various security brokers and lenders on a temporary basis for a fee. Up to 100 percent of the securities may be available for loan. All security loan agreements are collateralized at loan inception at 102 percent of

market value by cash or U.S. Government obligations and adjusted to market daily to cover market value fluctuations; therefore, management believes there is no assumed credit risk.

In accordance with Statement No. 28 of the Governmental Accounting Standards Board, balances for “Cash held as collateral” and “Obligations under securities lending,” reflect the recommended reporting. For the year ended June 30, 2002, the market value of investment account securities on loan was \$130,585,252 secured by \$132,690,304 in cash deposits, and \$218,721,256 secured by \$223,095,681 in market value securities that cannot be pledged or loaned. For the year ended June 30, 2001, the market value of investment account securities on loan was \$230,576,478 secured by \$236,700,552 in cash deposits, and \$185,705,275 secured by \$189,419,381 in market value securities that cannot be pledged or loaned.

Cash held as collateral from treasury security lending represents the Lottery’s share of cash collateral received on security lending transactions associated with their investment of Lottery cash held in the General Account of the Commonwealth. Information related to the credit risk of these securities lending transactions is available on a statewide level in the Commonwealth of Virginia’s Comprehensive Annual Financial Report.

	At June 30, 2002			
	Category		Carrying Amount	Market Value
	1	3		
<u>Cash and Cash Equivalents</u>				
Cash on deposit	\$ 519,352	\$ -	\$ 519,352	\$ 519,352
Repurchase agreements	-	3,698,102	3,698,102	3,698,102
Cash with Treasurer of Virginia	-	-	6,067,972	6,067,972
Petty cash	-	-	4,560	4,560
Total cash and cash equivalents	<u>\$ 519,352</u>	<u>\$ 3,698,102</u>	<u>\$ 10,289,986</u>	<u>\$ 10,289,986</u>
<u>Cash held as collateral</u>				
Lottery securities lending	\$ -	\$ -	\$130,585,252	\$ 130,585,252
Treasury securities lending	-	-	564,095	564,095
Total cash collateral	<u>\$ -</u>	<u>\$ -</u>	<u>\$131,149,347</u>	<u>\$131,149,347</u>
<u>Investments</u>				
U. S. Government Securities	<u>\$449,693,965</u>	<u>\$ -</u>	<u>\$449,693,965</u>	<u>\$509,095,094</u>

	At June 30, 2001			
	Category		Carrying Amount	Market Value
	1	3		
<u>Cash and Cash Equivalents</u>				
Cash on deposit	\$ (553,225)	\$ -	\$ (553,245)	\$ (553,245)
Repurchase agreements	-	2,527,852	2,527,852	2,527,852
Cash with Treasurer of Virginia	-	-	21,439,921	21,439,921
Petty cash	-	-	4,560	4,560
Total cash and cash equivalents	<u>\$ (553,225)</u>	<u>\$ 2,527,852</u>	<u>\$ 23,419,088</u>	<u>\$ 23,419,088</u>
<u>Cash held as collateral</u>				
Lottery securities lending	\$ -	\$ -	\$230,576,478	\$ 230,576,478
Treasury securities lending	-	-	2,900,601	2,900,601
Total cash collateral	<u>\$ -</u>	<u>\$ -</u>	<u>\$233,477,079</u>	<u>\$ 233,477,079</u>
<u>Investments</u>				
U. S. Government Securities	<u>\$461,642,912</u>	<u>\$ -</u>	<u>\$461,642,912</u>	<u>\$508,713,974</u>

3. FIXED ASSETS

The following schedule presents the changes in Fixed Assets by category.

	Balance as of July 1, 2001	Additions	Reductions	Balance as of June 30, 2002
Furniture, fixtures and equipment	\$ 55,422,399	\$ 5,910,243	\$ 20,791,908	\$ 40,540,734
Less: Accumulated depreciation	<u>33,799,672</u>	<u>5,861,378</u>	<u>19,970,448</u>	<u>19,690,602</u>
Net fixed assets	<u>\$ 21,622,727</u>	<u>\$ 48,865</u>	<u>\$ 821,460</u>	<u>\$ 20,850,132</u>
	Balance as of July 1, 2000	Additions	Reductions	Balance as of June 30, 2001
Furniture, fixtures and equipment	\$ 49,082,018	\$ 15,715,252	\$ 9,374,871	\$ 55,422,399
Less: Accumulated depreciation	<u>39,068,831</u>	<u>3,801,217</u>	<u>9,070,376</u>	<u>33,799,672</u>
Net fixed assets	<u>\$ 10,013,187</u>	<u>\$ 11,914,035</u>	<u>\$ 304,495</u>	<u>\$ 21,622,727</u>

4. INSTANT TICKET INVENTORY

Inventories are valued at cost, using a weighted average basis, and are expensed over the life of each game as it is sold to retailers.

5. DUE FROM (TO) THE LOTTERY PROCEEDS FUND

The amount due from (to) the Lottery Proceeds Fund represents Virginia Lottery net income payable to the Commonwealth of Virginia's General Fund in accordance with Section 3-1.01(G) of Chapter 814, 2002 Acts of Assembly, and Section 58.1-4022, Code of Virginia. The Lottery Proceeds Fund is a special non-reverting fund established solely for the purpose of public education in the Commonwealth.

	Year Ended June 30, 2002	Year Ended June 30, 2001
Net Income	\$ 367,693,383	\$ 329,142,392
Less:		
Transfer of net income through June 30	<u>367,690,664</u>	<u>329,581,852</u>
Balance due from (to) the Lottery Proceeds Fund	<u>\$ (2,719)</u>	<u>\$ 439,460</u>

6. PRIZES PAYABLE

Jackpot prizes are paid in 20, 25, 26 or 30 installments. The first installment is paid on the day the prize is claimed. The subsequent annual payments are funded with U.S. Treasury STRIPS purchased by the Virginia Lottery. For Life prizes payable represent estimated prizes payable monthly, quarterly or annually for the life of the winner based on life expectancy tables from the Virginia Bureau of Insurance, and funded with a pool of U.S. Treasury STRIPS.

Jackpot prizes payable represent the future annual prize payments valued at cost plus accrued interest (present value of securities held to maturity) of the investment securities funding the payments.

	Year Ended June 30, 2002			Year Ended June 30, 2001
	Jackpot	For Life	Total	Total
Jackpot Prizes Payable:				
Due within one year	\$ 56,003,064	\$ 1,148,390	\$ 57,151,454	\$ 56,368,389
Due in subsequent years	<u>378,670,483</u>	<u>13,872,028</u>	<u>392,542,511</u>	<u>405,274,523</u>
Total (present value)	434,673,547	15,020,418	449,693,965	461,642,912
Add: Interest to maturity	<u>203,925,453</u>	<u>15,065,582</u>	<u>218,991,035</u>	<u>235,948,088</u>
Jackpot prizes payable at maturity	<u>\$638,599,000</u>	<u>\$30,086,000</u>	<u>\$ 668,685,000</u>	<u>\$ 697,591,000</u>

Other prizes payable represent unclaimed prizes from drawings or games which have ended and are redeemable up to 180 days after the drawing or game end. For Life prizes, for which bonds have not been purchased are reported as other prizes payable.

The following schedule presents the changes in prizes payable.

Balance as of July 1, 2000	Increases	Decreases	Balance as of June 30, 2001	Increases	Decreases	Balance as of June 30, 2002
<u>\$502,585,966</u>	<u>\$22,830,932</u>	<u>\$63,773,986</u>	<u>\$461,642,912</u>	<u>\$13,348,392</u>	<u>\$25,297,339</u>	<u>\$449,693,965</u>

7. INSTALLMENT PURCHASE AND OPERATING LEASE COMMITMENTS

The Virginia Lottery is committed under various installment purchase agreements and operating lease agreements. The installment purchase agreement is for our new online terminals (ISYS). This is a five year installment loan with interest rates ranging from 3.94 percent to 4.483 percent. The operating leases are for regional offices and instant validation equipment (Sci-Scan). Original book value of equipment capitalized under installment purchase agreements totals \$14,248,000 at June 30, 2002 and June 30, 2001. Expenses under operating lease agreements were \$5,408,020 and \$5,509,661 as of June 30, 2002 and 2001, respectively. A summary of future obligations under these agreements as of June 30, 2002 follows:

Year Ending June 30	Operating Lease Obligation	Principal	Interest	Installment Purchase Obligations
2003	\$ 3,020,955	\$ 2,701,495	\$ 481,040	\$ 3,182,535
2004	268,131	2,822,180	355,670	3,177,850
2005	276,130	2,948,268	229,582	3,177,850
2006	264,368	3,080,004	97,846	3,177,850
2007	<u>362,348</u>	<u>615,680</u>	<u>13,238</u>	<u>628,918</u>
Total commitments and gross minimum payments	<u>\$ 4,191,932</u>	<u>\$12,167,627</u>	<u>\$1,177,376</u>	<u>\$ 13,345,003</u>

The following schedule presents the changes in installment purchases.

Balance as of July 1, 2000	Increases	Decreases	Balance as of June 30, 2001	Increases	Decreases	Balance as of June 30, 2002
<u>\$-</u>	<u>\$11,398,400</u>	<u>\$-</u>	<u>\$11,398,400</u>	<u>\$2,849,600</u>	<u>\$2,080,373</u>	<u>\$12,167,627</u>

8. COMPENSATED ABSENCES

Compensated absences represent the amounts of vacation, sick, and compensatory leave earned by employees of the Virginia Lottery but not taken at June 30, 2002 and 2001. Compensated absences were calculated in accordance with Governmental Accounting Standards Board (GASB) Statement No. 16 "Accounting for Compensated Absences." The amount reflects all earned leave payable under the Commonwealth of Virginia's leave payout policies. Information on the Commonwealth's leave policy is available at the statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

<u>Balance as of</u> <u>July 1, 2000</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance as of</u> <u>June 30, 2001</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance as of</u> <u>June 30, 2002</u>
<u>\$1,554,587</u>	<u>\$850,638</u>	<u>\$872,858</u>	<u>\$1,532,367</u>	<u>\$858,717</u>	<u>\$805,713</u>	<u>\$1,585,371</u>

9. LINE OF CREDIT

The State Comptroller has provided the Virginia Lottery with a line of credit not to exceed \$25,000,000 in accordance with Section 32.03 of Chapter 814, 2002 Acts of Assembly, to fund administrative and operating expenses in the event unreserved cash is insufficient to cover these short-term costs. There were no borrowings as of June 30, 2002 and 2001.

10. LITERARY FUND AND SETOFF DEBT COLLECTION PAYMENTS

Prizes unclaimed after 180 days are paid to the Literary Fund of the Commonwealth. Payments totaled \$9,195,847 and \$7,461,034 for the years ended June 30, 2002 and 2001, respectively.

The Virginia Lottery participates in the Setoff Debt Collection Act whereby certain prize payments are withheld to set-off state obligations the prize winner owes. Payments totaled \$685,426 and \$707,771 for the years ended June 30, 2002 and 2001, respectively. The Literary Fund and state debt setoff payments are reported as prize expense on the financial statements.

11. PENSION PLAN AND OTHER POST RETIREMENT BENEFITS

Employees of the Virginia Lottery are employees of the Commonwealth of Virginia. The employees participate in a defined benefit retirement plan administered by the Virginia Retirement System (VRS). The VRS also administers life insurance and health related plans for retired employees. Information relating to these plans is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report (CAFR). The Commonwealth of Virginia, not the Virginia Lottery, has the overall responsibility for contributions to these plans.

12. RISK MANAGEMENT

The Virginia Lottery is exposed to various risks of loss related to torts: theft or, damage to, and destruction of assets; errors and omissions; non-performance of duty; injuries to employees; and natural disasters. The Virginia Lottery participates in insurance plans maintained by the Commonwealth of Virginia. The state employee health care and worker's compensation plans are administered by the Department of Human Resource Management and the risk management insurance plans are administered by the Department of Treasury, Division of Risk Management. Risk management insurance includes property, general liability, medical malpractice, faithful performance of duty bond, automobile, and air and watercraft plans. The Virginia Lottery pays premiums to each of these Departments for its insurance coverage. Information relating to the Commonwealth's insurance plans is available at the statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

13. CONTINGENCIES

The Virginia Lottery is named as a party in several legal proceedings. It is not possible at the present time to estimate ultimate outcome or liability, if any, of the Virginia Lottery in respect to the various proceedings; however, it is believed that any ultimate liability resulting from these suits will not have a material, adverse effect on the financial condition of the Virginia Lottery.

14. GASB STATEMENT

GASB Statement No. 34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments, issued June 1999, became effective for the Commonwealth for fiscal year ending June 30, 2002. This Statement imposed new standards for financial reporting. Although the changes to the Department’s statements were minimal since its activity is accounted for in an enterprise fund, some comparative figures for the fiscal year ending June 30, 2001 were reclassified to conform to GASB No. 34 reporting requirements.

STATE LOTTERY DEPARTMENT
Richmond, Virginia

STATE LOTTERY BOARD
As of June 30, 2002

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